DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER 18-990118
FINANCIAL INSTITUTIONS TAX FOR THE PERIOD 1990-96

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ISSUES

I. Tax Procedure—Constitutional Challenges—Exhaustion of Administrative Remedies

Procedure—Notice of Proposed Assessment—Notice to Correct Entity—Unitary Groups (All Tax Periods)

Authority: IND. CONST. art. III, § 1; I.R.C. (26 U.S.C.) § 7701(a)(3) (1988) (1994); IC §§ 6-5.5-1-6, -1-18(b), -6-1 and -9-2 (1988 and Supps. 1989-92) (1993); IC § 6-8.1-1-1 (1993 and Supps. 1994-97) (1998); IC § 6-8.1-1-3 (1988) (1993) (1998); IC §§ 6-8.1-1-5.5 and -5-1 (1988 and Supps. 1989-92) (1993) (1998); *Mullane v. Central Hanover Bank & Tr. Co.,* 70 S.Ct. 652 (U.S. 1950); *American Auto Trimming Co. v. Lucas,* 37 F.2d 801 (D.C. Cir. 1930); *Anheuser-Busch, Inc. v. Comm'r,* 40 B.T.A. 1100 (1939); *State v. Sproles,* 672 N.E.2d 1353 (Ind. 1996); *Bethlehem Steel Corp. v. Indiana Dep't of State Revenue,* 639 N.E.2d 264 (Ind. 1994); *Middleton Motors, Inc. v. Indiana Dep't of State Revenue,* 380 N.E.2d 79 (Ind. 1978); *Dowd v. Grazer,* 116 N.E.2d 108 (Ind. 1953); *State ex rel. Standard Oil Co. v. Review Bd. of Employment Sec. Div.,* 101 N.E.2d 60 (Ind. 1951); *Owner-Operator Indep. Drivers Ass'n v. State Dep't of Revenue,* 725 N.E.2d 891 (Ind. Ct. App. 2000); *Felix v. Indiana Dep't of State Revenue,* 502 N.E.2d 119 (Ind. Ct. App. 1986); *Van Orman v. State,* 416 N.E.2d 1301 (Ind. Ct. App. 1981); *Associated Ins. Cos. v. Indiana Dep't of State Revenue,* 655 N.E.2d 1271 (Ind. Tax Ct. 1995); *Ball v. Indiana Dep't of State Revenue,* 525 N.E.2d 356, 358-359 (Ind. Tax Ct. 1988) ("*Ball I*"), *aff'd* 563 N.E.2d 522, 524 (Ind. 1990) ("*Ball II*"); 45 IAC § 15-5-1 (1988) (1992) (1996)

The protesting unitary group (hereinafter "the protestant," "the merged unitary group" or "the merged group") contends that the assessments are void because the Department addressed them to a member that was not the member that filed the combined returns for the unitary group.

II. Financial Institutions Tax—Imposition—Transacting Business of Financial Institution in Indiana—Regular Solicitation of Business in or Attribution of Receipts to Indiana (1993-96)

Tax Procedure—Protests—Burden of Proof

Authority: I.R.C. (26 U.S.C.) § 61 (1988) (1994); IC §§ 6-5.5-1-12, -17(a) and (d), -18(a), -2-1(a), -2-4, -3-1(6), -3-4, -3-5, -4-2(1), -4-4 to -4-6, -4-8, -6-9 and -8.1-5-4 (1988 and Supps. 1989-92) (1993); IC § 6-8.1-5-1(b) (1998); *Indiana Dep't of State Revenue v. Fort Wayne Nat'l Corp.,* 649 N.E.2d 109 (Ind. 1995); *State v. Huffman*, 643 N.E.2d 899 (Ind. 1994); *Peabody Coal Co. v. Ralston*, 578 N.E.2d 751 (Ind. Ct. App. 1991); *Porter Mem'l Hosp. v. Malak*, 484 N.E.2d 54 (Ind. Ct. App. 1985); *Canal Square Ltd. Partnership v. State Bd. of Tax Comm'rs*, 694 N.E.2d 801 (Ind. Tax Ct. 1998); *Longmire v. Indiana Dep't of State Revenue*, 638 N.E.2d 894 (Ind. Tax Ct. 1994); *Bullock v. Foley Bros. Dry Goods Corp.*, 802 S.W.2d 835 (Tex. App. 1990); 45 IAC § 15-5-3(b)(8) (2000); 45 IAC §§ 17-2-6(8), -8 and -3-10(b)(6)-(9) (1988 and Supp. 1991) (1992) (1996)

The protestant argues that the Department erred in imposing financial institutions tax (hereinafter "FIT") on three of its members because they did not regularly solicit business in Indiana.

III. Tax Procedure—Adjustments to Federal Returns—Timeliness of Notice to Department (1993)

Authority: I.R.C. (26 U.S.C.) §§ 6511(a), 6513(a) (1988) (1994); IC §§ 6-5.5-6-6(b), -8.1-5-2(f) and –9-1(a) (1993); IC § 33-3-5-11(a) (1998 and Supp. 2002); *Middleton Motors, Inc. v. Indiana Dep't of State Revenue,* 380 N.E.2d 79 (Ind. 1978); *Marhoefer Packing Co. v. Indiana Dep't of State Revenue,* 301 N.E.2d 209 (Ind. Ct. App. 1973); *Salin Bancshares, Inc. v. Indiana Dep't of State Revenue,* 744 N.E.2d 588 (Ind. Tax Ct. 2000); *GasAmerica Services, Inc. v. Indiana Dep't of State Revenue,* 552 N.E.2d 860 (Ind. Tax Ct. 1990); 45 IAC §§ 15-5-7(d) and -9-2 (1992)

The protestant submits that the auditor and the Department erred in denying the protestant the benefit of the adjustments to its 1993 federal income tax return, because it did not report those adjustments in a timely manner.

IV. Financial Institutions Tax—Imposition—Constitutionality—Due Process Nexus (1993-96)

Financial Institutions Tax—Imposition—Constitutionality—Interstate Commerce—Substantial Nexus (1993-96)

Financial Institutions Tax—Imposition—Constitutionality—Interstate Commerce—Fairness of Apportionment and Discrimination (1993-96)

Financial Institutions Tax—Credits—Non-Resident Taxpayers—Constitutionality--Fairness of Apportionment and Discrimination (1993-96)

Authority: IND. CONST. art. III, § 1; IC §§ 6-5.5-1-12, -1-13 and -2-4 to -6 (1988 and Supps. 1989-92) (1993); *Goldberg v. Sweet,* 109 S.Ct. 582 (U.S. 1989); *United States v. Salerno,*

107 S.Ct. 2095 (U.S. 1987); *Armco, Inc. v. Hardesty,* 104 S.Ct. 2620 (U.S. 1984); *Swan & Finch Co. v. United States,* 23 S.Ct. 702 (U.S. 1903); *Burroughs Adding Machine Co. v. Terwilliger,* 135 F2d 608 (6th Cir. 1943); *Miller v. McColgan,* 110 P.2d 419 (Cal. 1941); *Bigelow v. Reeves,* 149 S.W.2d 499 (Ky. 1941); *State v. Sproles,* 672 N.E.2d 1353 (Ind. 1996); *Middleton Motors, Inc. v. Indiana Dep't of State Revenue,* 380 N.E.2d 79 (Ind. 1978); *Dowd v. Grazer,* 116 N.E.2d 108 (Ind. 1953); *State ex rel. Standard Oil Co. v. Review Bd. of Employment Sec. Div.,* 101 N.E.2d 60 (Ind. 1951); *State ex rel. ANR Pipeline Co. v. Indiana Dep't of State Revenue,* 672 N.E.2d 91 (Ind. Tax Ct. 1996); *Auburn Foundry, Inc. v. State Bd. of Tax Comm'rs,* 628 N.E.2d 1260 (Ind. Tax Ct. 1994); *Tupelo Garment Co. v. State Tax Comm'n,* 173 So. 656 (Miss. 1937); *State ex rel. Whitlock v. State Bd. of Equalization,* 45 P.2d 684 (Mont. 1935); *Omaha Pub. Power Dist. v. Nebraska Dep't of Revenue,* 537 N.W.2d 312 (Neb. 1995); *TPQ Inv. Corp. v. State ex rel. Oklahoma Tax Comm'n,* 954 P.2d 139 (Okla. 1998); *Keyes v. Chambers,* 307 P.2d 498 (Or. 1957); *Burlington N. R.R. v. Strackbein,* 398 N.W.2d 144 (S.D. 1986); *Stephens v. Vermont Dep't of Taxes,* 353 A.2d 355 (Vt. 1976); *Cudahy v. Wisconsin Dep't of Taxation,* 52 N.W.2d 467 (Wis. 1952); 45 IAC §§ 17-3-7(e) and -8(b) (1988 and Supp. 1991) (1992) (1996)

The protestant contends that the FIT as applied to the three members in question violates due process and the dormant Interstate Commerce Clause because those corporations allegedly have no substantial nexus with Indiana. The protestant also submits that the FIT further violates the dormant Interstate Commerce Clause because IC § 6-5.5-2-4 apportions unfairly and thereby discriminates against interstate commerce. Lastly, the protestant argues that the credit for nonresident taxpayers of IC § 6-5.5-2-6 does not completely cure these alleged defects.

V. Tax Administration—Negligence Penalties (1993-96)—Reasonable Difference of Opinion as to Liability for Tax

Authority: IND. CONST. art. III, § 1; IC § 6-5.5-7-1(a) and -8.1-10-2.1(b) and (d) (1993); *State v. Sproles,* 672 N.E.2d 1353 (Ind. 1996); *Middleton Motors, Inc. v. Indiana Dep't of State Revenue,* 380 N.E.2d 79 (Ind. 1978); *Dowd v. Grazer,* 116 N.E.2d 108 (Ind. 1953); *State ex rel. Standard Oil Co. v. Review Bd. of Employment Sec. Div.,* 101 N.E.2d 60 (Ind. 1951); *Indiana Dep't of State Revenue v. Harrison Steel Castings Co.,* 402 N.E.2d 1276 (Ind. Ct. App. 1980); 45 IAC § 15-11-2(b) and (c) (1992) (1996)

The protestant argues that the Department should abate the negligence penalties for calendar years 1993-95 and the years ending March 31, 1996 and December 31, 1996 because a reasonable difference of opinion exists as to the constitutionality of the tax.

VI. Tax Administration—Negligence Penalties (1990-92)—Reasonable Cause—Merger and Layoff of Compliance Personnel

Authority: IC § 6-5.5-7-1(a) (1988 and Supps. 1989-91); IC § 6-8.1-5-1(b) (1998); IC § 6-8.1-10-2 (1988); IC § 6-8.1-10-2.1 (1988 and Supps. 1991-92); 45 IAC § 15-11-2(b) and (c) (1988) (1992)

The protestant contends that reasonable cause exists to abate the penalty for calendar years 1990-92 due to a merger and attendant layoff of tax compliance personnel that it alleges caused it to fail to timely report certain adjustments to its federal corporate returns to the Department.

SUMMARY OF FINDINGS

The Department denies this protest as to all issues for the reasons set out below in the respective Discussion of each issue.

STATEMENT OF FACTS

The Department audited the protesting entity for financial institutions tax (hereinafter "FIT") for calendar years 1990-96 (hereinafter "the audit period"). From the beginning of 1990 through the end of the first quarter of 1996 that entity was an affiliated group consisting of a parent bank holding company (hereinafter "the original parent" or "the original holding company") and numerous affiliate members. The original parent and its affiliates functioned as a unitary group (see IC § 6-5.5-1-18(a) (1988 and Supp. 1992) (1993) (1998) for the definitions of "unitary business" and "unitary group"), so the Department will hereinafter refer to them as "the original unitary group" or "the original group". On April 1, 1996 a "reverse acquisition" merger occurred (*see generally* 26 C.F.R. (Treas. Reg.) § 1.1502-75(d)(3)(i) (1996)). As a result, the original holding company and the original unitary group were merged into, and became members of, a larger affiliated group also functioning as a unitary group (hereinafter "the acquiring unitary group" or "the acquiring group") headed by another bank holding company (hereinafter "the acquiring parent"). The resulting entity adopted the original holding company's name, and also filed this protest.

Ordinarily the Department would simply refer to a protesting entity as "the taxpayer," or possibly as "the licensee" if the protest in question involves assessment of a license tax. However, among other things, the present protesting entity contends that the Department mailed the Notices of Proposed Assessment for the underlying audit to the wrong taxpayer. Specifically, the protesting entity submits that the Department erroneously sent those Notices to the original parent. The protesting entity argues that instead the Department should have sent the Notices to another member of the original and merged unitary groups that they designated to file the combined Forms FIT-20 (Financial Institution Franchise Tax Return) on their behalves during the audit period. (The Department will hereinafter refer to this member as "the filing member" or "the filer.") To resolve this issue the Department will have to determine who was the taxpayer and who was, or were, the member or members of the merged unitary group to which the Department was legally empowered to send those Notices, as it will discuss under Issue I below. Given this circumstance and the occurrence of the "reverse acquisition" merger, the Department would unnecessarily complicate discussion of the other issues and confuse readers of this letter if it were to refer to the present protesting entity as "the taxpayer." Therefore, to avoid these problems and to promote clarity, the Department in this letter will refer to this entity as "the merged unitary group," "the merged group" or "the protestant."

The original, acquiring and merged groups all filed consolidated federal Forms 1120 (U.S. Corporation Income Tax Return) during the audit period. All federal returns were filed under the

name of the original holding company. As a result of the reverse acquisition the original unitary group filed a final Form 1120 and a final combined Form FIT-20 for the first quarter of 1996. The merged unitary group filed another 1120 and another FIT-20 that reflected the activities of the original group and the original parent for the last three quarters of 1996 and of the acquiring parent and the acquiring unitary group for all of calendar 1996. There was no difference between the companies listed as being members of the original federal affiliated and original Indiana unitary groups, or between those listed as being members of the merged federal affiliated and merged Indiana unitary groups.

However, in the FIT-20s from 1993 through the end of the audit period, the reporting unitary group in question included in the numerator of the apportionment calculation only receipts of affiliate members that the group represented had tangible property or personnel in Indiana. The effect of this action was that the group in question reported Indiana receipts for only the filer and one other member for calendar years 1993-95 and only the filing member for 1996. The reporting group in question excluded from the apportionment numerator the receipts of all members represented as not having property or personnel in Indiana, which constituted all other members of the reported group, including the original and acquiring parents. As justification for this position a short written statement to this effect was attached to each FIT-20 for the 1993-96 reporting periods questioning the constitutionality of unspecified parts of IC § 6-5.5-3-1.

Three of the six issues in this protest arise out of the imposition of FIT on receipts earned during these years by three members of the original group that the merged unitary group alleges fell into this latter category. The Department will refer to these members hereinafter as Members A, B and C. Member A is a corporation chartered in a state other than Indiana and specialized in commercial real estate financing. Members B and C are both national banks. Members A and B were reported as being members of the original or merged unitary group during each reporting period in calendar years 1993-96. Member C joined and was reported as being a member of the original group in calendar year 1995 and was reported as being a member of the reporting group in question on both of the 1996 returns. None of these three members was the filer. All three had their commercial domiciles outside Indiana. None was admitted to do business in Indiana during the audit period according to the on-line records of the Department of Financial Institutions and the Business Services Division of the Secretary of State's office. The field auditor added to the numerator of the apportionment formula receipts that one or more of these members, and others, earned from loans or installment sales primarily secured by tangible property in Indiana, unsecured consumer loans to Indiana debtors, unsecured commercial loan or installment obligation proceeds applied to Indiana, and credit card charges billed to Indiana addresses. The Notices of Proposed Assessment indicate that the bulk of the resulting FIT was imposed on receipts earned during calendar years 1993-95 and the two 1996 return periods.

The auditor also made, and in one case declined to make, adjustments relating to certain omissions relating to tax compliance. The protestant submitted Internal Revenue Service ("IRS") Revenue Agent Reports ("RARs") for calendar years 1990-91, and amended federal corporate income tax returns (Form 1120X) for calendar years 1992-93, for the original unitary group that had not been submitted to the Department before. The 1990-91 RARs and the 1120X for 1992 indicated increases to the original group's federal corporate tax liability, while the 1993 1120X indicated that the federal income of original unitary group was reduced (thereby entitling

it to a refund or credit of FIT). The auditor made adjustments to the original group's FIT liability for calendar years 1990-92 based on these returns. However, she declined to do so for calendar year 1993 on the ground that the changes reported on the amended federal return for that year had not been reported to the Department within one hundred twenty (120) days after the modification to the federal return for that year. The only evidence in the audit file of when the merged unitary group notified the Department is an entry in the auditor's progress report (i.e., log) dated March 30, 1998 and documenting a conversation between her and the merged group's successor contact person for the audit. In that conversation the successor contact person indicated that she believed that the 1993 Form 1120X was filed in 1995, which would have been before the merger. The successor contact person represented that she would get back with the auditor if he found any proof that the Department had received timely notice, but never did so. The merged unitary group has not provided any such proof during this protest, nor is there any such proof in the file.

The Department assessed penalties for all years of the audit period for failing to follow the regulations on sourcing of loan, credit interest and fee receipts and for failing to report and pay the tax on such items.

The auditor also submitted the Audit Summary under the name and federal identification number of the original parent. Her reasons for doing so, as stated in the Audit Summary, were twofold. First, the auditor stated that before the FIT was enacted the original unitary group was the same entity that had filed Indiana income tax returns. Second, she noted that the original parent had been the responsible filing member of the original federal consolidated group during the audit period. The Department issued the Notices of Proposed Assessment to the original holding company, rather than to the Indiana filing member, as a result. The original parent, rather than the filing member, submitted this protest. Additional facts will be provided if and as needed under the Discussion of each issue below.

I. Tax Procedure—Constitutional Challenges—Exhaustion of Administrative Remedies

Tax Procedure—Notice of Proposed Assessment—Notice to Correct Entity—Unitary Groups (All Tax Periods)

DISCUSSION

A. INTRODUCTION: INDIANA LAW REQUIRES EXHAUSTION OF ADMINISTRATIVE REMEDIES IF A TAX IS CHALLENGED ON CONSTITUTIONAL GROUNDS.

As the Department will summarize under the Discussion of Issue III below, the protestant has challenged the assessment in this protest on two federal constitutional grounds. For this reason, the Department will discuss at the outset the Indiana law governing the administrative procedure to be followed when a constitutional challenge is made to an assessment of a tax that this Department administers.

The Indiana Supreme Court has held that constitutional analysis is beyond the Department's expertise. *State v. Sproles,* 672 N.E.2d 1353, 1360 (Ind. 1996). Taxpayer claims that a tax statute is unconstitutional on its face in particular are beyond the Department's administrative authority and adjudicative jurisdiction on the additional ground of the Indiana state constitutional doctrine of separation of powers. IND. CONST. art. III, § 1; *Dowd v. Grazer,* 116 N.E.2d 108, 112 (Ind. 1953); *State ex rel. Standard Oil Co. v. Review Bd. of Employment Sec. Div.,* 101 N.E.2d 60, 66 (Ind. 1951). However, it is also well settled that a taxpayer challenging on constitutional grounds a tax statute that the Department administers or a tax that it has levied nevertheless must make that challenge by exhausting, and may not bypass, its statutory administrative remedies before raising it in the Indiana Tax Court. *Sproles,* 672 N.E.2d at 1361, citing, among other opinions*, Felix v. Indiana Dep't of State Revenue,* 502 N.E.2d 119 (Ind. Ct. App. 1986); *Owner-Operator Indep. Drivers Ass'n v. State Dep't of Revenue,* 725 N.E.2d 891, 893-94 (Ind. Ct. App. 2000) (citing *Sproles*). As a matter of procedure the protestant therefore was correct to raise its constitutional issues with the Department initially. The Court of Appeals in *Felix* stated the reasons for the exhaustion requirement as follows:

> [T]he "absolute and indispensible [sic] prerequisite" of [exhausting administrative remedies] "serves to advise the appropriate internal revenue officials of the claims intended to be asserted by the taxpayer, so as to insure an orderly administration of the revenue." *McConnell v. United States* (E.D. Tenn. 1969), 295 F. Supp. 605, 606. Finally, *the requirement of [exhausting administrative remedies] even for a constitutional challenge will afford the Department the opportunity to resolve the matter on nonconstitutional grounds. See Christian v. New York State Department of Labor* (1974), 414 U.S. 614, 622-24, 94 S.Ct. 747, 751-52, 39 L.Ed.2d 38, 45-47. *For example, the Department may determine in an audit that [a taxpayer's] claimed refund is inappropriate for other reasons or that is [sic] allowable under other tax provisions. Weinberger v. Salfi* (1975), 422 U.S. 749, 762, 95 S.Ct. 2457, 2465, 45 L.Ed.2d 522, 537.

502 N.E.2d at 122 (emphases added), approved in *Sproles*, 672 N.E.2d at 1361. The Department interprets the emphasized language as requiring it, whenever possible, to decide any tax protest in which, or any issue in a protest in connection with which, the taxpayer in question has raised constitutional issues on any non-constitutional grounds that taxpayer may also have raised. *See Bethlehem Steel Corp. v. Indiana Dep't of State Revenue,* 639 N.E.2d 264, 272 (Ind. 1994) (finding it unnecessary to resolve a constitutional challenge after deciding the case on non-constitutional grounds). However, if the Department cannot successfully resolve a protest on such alternative grounds, or if a taxpayer has not raised any non-constitutional issues, it will only address claims of unconstitutionality to the extent necessary to resolve a protest and only as applied to the taxpayer and assessment in question. In addition, the Department will do so only to the extent authorized, or at least not barred, by statute or constitutional provision. In particular, the Department cannot and will not entertain facial attacks on a statute concerning a tax that it administers. IND. CONST. art. III, § 1; *Grazer,* 116 N.E.2d at 112; *Standard Oil,* 101 N.E.2d at 66.

As the Department will explain under its Discussion of Issue IV below, the present protestant has attacked the FIT, and the credit against that tax for nonresident taxpayers, on their faces rather than as applied to it in this audit. IND. CONST. art. III, § 1 as interpreted in *Grazer* and *Standard Oil* therefore prevent the Department from addressing these arguments. However, in addition to its constitutional challenges, the merged unitary group has also attacked the assessment on three non-constitutional grounds. Accordingly, and consistent with *Felix* as approved in *Sproles*, the Department will address these non-constitutional arguments.

B. THE PROTESTANT'S ARGUMENT

As noted in the Statement of Facts, the Department issued the Notices of Proposed Assessment to the original parent. The merged unitary group contends that the Department should have served the Notices on the filing member instead. In so arguing the merged group implies that the Department must read the first sentence of 45 IAC § 15-5-1 (1988) (1992) (1996) literally as requiring it to serve the Notices of Proposed Assessment on the filing member as the taxpayer that improperly reported that group's and the original unitary group's FIT liability.

More importantly, the protestant also submits that the Department's serving the Notices on the original parent instead of the filing member invalidated the proposed assessments. The protestant argues that the original parent was neither a "taxpayer" as defined in IC § 6-5.5-1-17(a) nor the filing taxpayer member of the unitary group for purposes of IC §§ 6-5.5-6-1 and -2-4, and therefore was not the proper entity upon which the Department should have served the Notices of Proposed Assessment. Implicit in this argument is the proposition that the definition of "taxpayer" in IC § 6-5.5-1-17(a) should also define that word in 45 IAC § 15-5-1 when the Department serves a Notice of Proposed Assessment of FIT, in order to identify the allegedly correct entity upon which to serve that Notice.

C. THE DEPARTMENT'S RESTATEMENT OF THE ISSUES

The Department views this matter somewhat differently than does the merged unitary group. In the Department's view the real questions to be answered are threefold. The first is whether the word "taxpayer" in this factual context refers to the entire original or merged unitary group the returns for the period in question covered, or the member that actually prepared and filed those returns, or caused them to be prepared and filed. The second and third questions are related to each other but distinct from the first question. They are, second, whether the Department was legally empowered to send the Notices of Proposed Assessment to the original parent, and third, whether the original parent was empowered to receive those Notices on behalf of the merged unitary group.

D. THE "TAXPAYER" ON WHICH THE DEPARTMENT SERVED THE NOTICES OF PROPOSED ASSESSMENT WAS THE ENTIRE MERGED UNITARY GROUP

Turning first to the question of the identity of the "taxpayer," it is necessary at the outset to put 45 IAC § 15-5-1, and its use of that word, into the proper legal context. This regulation read during the audit period, and at this writing still reads, as follows:

> Sec. 1. If the department believes that a *taxpayer* has improperly reported a listed tax liability, the department may at any time within the prescribed statute of limitations period issue to such *taxpayer* a formal notice that the department proposes to assess additional tax. The formal notice shall be based on the best information available to the department. Any written advisement which informs the *taxpayer* of the amount of the proposed assessment for a particular tax period shall constitute a formal notice. A formal notice shall be sent through the United States mail.

Id (emphases added). The Department promulgated 45 IAC § 15-5-1 as one of the regulations intended to implement IC § 6-8.1-5-1, which forms part of the Tax Administration Act, P.L. 61, § 1, 1980 Ind. Acts 660, 660-684, codified as amended at IC article 6-8.1 (1998) (hereinafter "the TAA"). The TAA governs the procedures for assessment, collection and administration of the taxes for which the General Assembly has made the Department responsible. IC § 6-8.1-1-1 appropriately defines them as being "listed taxes," compiling them and citing to the parts of IC title 6 in which they are located. *Id.* The Financial Institutions Tax Act, P.L. 347-1989(ss), § 1, 1989 Ind. Acts 2496, 2496-2519, codified as amended at IC article 6-5.5 (1988 and Supps. 1989-92) (1993 and Supps. 1994-97) (hereinafter "the FITA"), has made the FIT a listed tax ever since it first took effect on January 1, 1990 (*see id.* §§ 1 and 31, 1989 Ind. Acts at 2496 and 2540, respectively, indicating effective date). The FITA includes IC § 6-5.5-9-2, 1989 Ind. Acts at 2518, which states that "[f]or purposes of administration and enforcement the provisions of IC 6-8.1 that are applicable to a listed tax and an income tax apply to the tax imposed by this article." *Id.* (The legislature made a technical amendment to add the FIT to IC § 6-8.1-1-1 during the audit period in P.L. 71-1993, § 15, 1993 Ind. Acts 3294, 3310.) The TAA thus applies to questions of the Department's authority to administer the FIT.

It follows that for purposes of determining the entities upon whom the Department is authorized to serve a Notice of Proposed Assessment of FIT under 45 IAC § 15-5-1 that the definition of "taxpayer" in IC § 6-8.1-1-5.5 controls. That definition is broad enough to include the definition of "taxpayer" in IC § 6-5.5-1-17(a). The latter statute defines "taxpayer" for purposes of the FITA as "a *corporation* that is transacting the business of a financial institution in Indiana[.]" *Id* (emphasis added). (*But see* IC § 6-5.5-1-18(a) (indicating that a unitary group can also include "a partnership, a limited liability company, or a trust, … or any other entity, … that conducts … the business of a financial institution …[,]" *id.*). The FITA's definition of "corporation" in IC § 6-5.5-1-6 reads as follows:

> "Corporation" means an entity that is:
>
> (1) A corporation (as defined in Internal Revenue Code [26 U.S.C.] Section 7701(a)(3)) for federal income tax purposes, including an entity taxed as a corporation under the Internal Revenue Code; and
>
> (2) Organized under the laws of the United States, this state, any other taxing jurisdiction, or a foreign government.

Id. (I.R.C. § 7701(a)(3) (1988) (1994) in turn states that "[t]he term 'corporation' includes associations, joint-stock companies, and insurance companies." *Id.*) In contrast, IC § 6-8.1-1-5.5 states that "'taxpayer' means a *person* liable for the payment of taxes." *Id* (emphasis added). The TAA's definition of "person" in IC § 6-8.1-1-3 "includes [in relevant part] … national bank, bank, … *corporation*, …*or any group or combination acting as a unit.*" *Id* (emphases added). This definition thus includes all of the entities described in IC § 6-5.5-1-6 and I.R.C. § 7701(a)(3). That being the case, the merged group's argument that the definition of "taxpayer" in IC § 6-5.5-1-17(a) applies to 45 IAC § 15-5-1 in this protest raises an unnecessary argument that does nothing to advance its position.

Moreover, the Department would observe that the protestant's argument that the first sentence of 45 IAC § 15-5-1 authorized service of the Notices only on the filing member is a double-edged sword for the protestant. The reason this is so is because the sections of the TAA that deal with protest procedure imply that the person to whom the Department sent the Notice of Proposed Assessment is also the person that has standing to protest that assessment. For example, IC § 6-8.1-5-1(c) requires that "[t]he notice [of proposed assessment] shall state that *the person* [to whom the Department sent it] has sixty (60) days from the date the notice is mailed to pay the assessment or to file a written protest." *Id* (emphasis added). In the same vein, IC § 6-8.1-5-1(e) states that "the department shall issue a letter of findings and shall send a copy of the letter through the United States mail *to the person who filed the protest*…." *Id* (emphasis added).

Carrying the merged unitary group's argument to its logical conclusion, if its literal interpretation of the first sentence of 45 IAC § 15-5-1 were adopted, then it follows that IC § 6-8.1-5-1(c) and (e) would also have to be interpreted literally as giving only the filer standing to protest. However, the merged group submitted the original protest letter in this dispute on letterhead of the original parent, signed by its then Senior Tax Counsel and Vice President, and not in the name of the filing member. Therefore, if the Department were to agree with the merged group's argument and sustain it on this issue, the Department also would have to treat this protest as having been submitted *ultra vires* and deny it in its entirety for lack of standing, or at the very least for failure to join an indispensable party.

Fortunately for the merged unitary group, the TAA does not require such a result. As previously noted, the definition of "person" in IC § 6-8.1-1-3 "includes … *any group or combination acting as a unit.*" *Id* (emphasis added). In turn, IC § 6-8.1-1-5.5 states that " 'taxpayer' means *a person* liable for the payment of taxes[,]" *id.* These two quotations, as applied to 45 IAC § 15-5-1 and IC § 6-8.1-5-1(c) and (e), are thus plainly sufficient to interpret those authorities as referring, in a situation involving an income or franchise tax audit of a group, to the entire group that the erroneous return covers. *Cf. Associated Ins. Cos. v. Indiana Dep't of State Revenue,* 655 N.E.2d 1271, 1274 (Ind. Tax Ct. 1995) (stating that "[t]he spirit and intent of the [former] gross income tax consolidated filing statute is to treat an affiliated group as a single taxpayer[ ]"). It therefore follows that when the Department serves a Notice of Proposed Assessment in such a situation, or the group covered by the erroneous return protests the proposed assessment, the effect of the Notice or protest is not restricted just to the member that filed or caused the filing of the erroneous return. The Notice covers, and the protest binds, the whole group. These results are consistent with the Indiana rules of statutory interpretation that statutes governing tax assessment and collection, and remedial statutes (including statutes containing tax remedies, such as the

TAA), are to be liberally construed. *See Department of Treasury v. Dietzen's Estate,* 21 N.E.2d 137, 139 (Ind. 1939) (tax assessment statutes); *Economy Oil Corp. v. Indiana Dep't of State Revenue,* 321 N.E.2d 215, 218 (Ind. Ct. App. 1974) (same, citing *Dietzen's Estate*). *See also W. H. Dreves, Inc. v. Osolo Sch. Twp.,* 28 N.E.2d 252, 254 (Ind. 1940) (remedial statutes), citing, *inter alia, Board of Comm'rs of Marion County v. Millikan,* 190 N.E.185 (Ind. 1934) (property tax refund case).

E. THE DEPARTMENT'S SERVICE OF THE NOTICES OF PROPOSED ASSESSMENT ON THE ORIGINAL PARENT INSTEAD OF THE FILING MEMBER WAS VALID AND ACTED AS SERVICE ON ALL MEMBERS OF THE MERGED UNITARY GROUP.

The FITA and case law support the proposition that service on the original parent was proper. The last sentence of IC § 6-5.5-6-1 makes each member of a unitary group jointly and severally liable for the FIT liability of the group. Treating service of the Notices of Proposed Assessment on any member of the merged unitary group, including the original parent, as providing notice to all the other group members is thus completely consistent with the last sentence of IC § 6-5.5-6-1. It is also consistent with the "joint contractor" theory of liability on which the District of Columbia Court of Appeals relied in American *Auto Trimming Co. v. Lucas,* 37 F.2d 801, 804 (D.C. Cir. 1930). In that case the Commissioner of Internal Revenue had failed to serve a notice of deficiency on one of two sibling corporations (the same individual owning all or a substantial majority of the stock in each). The former Board of Tax Appeals (the predecessor to the United States Tax Court) found and asserted deficiencies against both corporations, which appealed. In response, the Court of Appeals said that "[t]he filing of a consolidated return by the Detroit and Cleveland [American Auto Trimming] companies was an assertion and an admission of identity of interest. Their situation was not unlike that of joint contractors, so that *notice to either was notice to both.*" *Id.* at 804 (internal quotation marks omitted) (emphasis added), *followed in Anheuser-Busch, Inc. v. Comm'r,* 40 B.T.A. 1100, 1109 (1939).

There is also Indiana judicial precedent that provides analogous support for treating the service of the Notices on the original parent as giving notice to all the other group members. Indiana law is well settled that if the Department has served a corporation with a Notice of Proposed Assessment for an unpaid "trust fund" tax (e.g., sales or withholding tax), procedural due process does not require separate service of a Notice for the same tax on the responsible officer/s who had the statutory duty of collecting and remitting those taxes. *Ball v. Indiana Dep't of State Revenue,* 525 N.E.2d 356, 358-359 (Ind. Tax Ct. 1988) ("*Ball I*"), *aff'd* 563 N.E.2d 522, 524 (Ind. 1990) ("*Ball II*"), both following *Mullane v. Central Hanover Bank & Tr. Co.,* 70 S.Ct. 652, 657 (U.S. 1950) and *Van Orman v. State,* 416 N.E.2d 1301, 1306 (Ind. Ct. App. 1981). In that situation notice to the corporation is considered to be notice to the responsible officer sufficient to satisfy procedural due process. *Ball II,* 563 N.E.2d at 524.

In both *Ball* and *Van Orman* the person against whom the Department asserted responsible officer status was president of and majority shareholder in the corporation liable for sales tax. The Indiana Supreme Court expressed the rationale for holding such persons to have notice of the proposed assessment trust fund tax as follows:

> Under [the trust fund tax collection statutes], only those persons who have a duty to remit such assessments can be held personally liable for the failure to remit those taxes that are to be held in trust for the State. Thus, because these persons serving the corporation have direct and immediate *control* of the internal corporate processes dealing with these entrusted funds, it may be safely assumed that they are aware of the responsible officer statute which is the source of their potential personal liability and that they are aware of and privy to corporate correspondence relating to their corporate duties including notices of assessment sent to the corporation.

Id (emphasis added). The Court of Appeals' analysis in *Van Orman* was to the same effect, although blunter because the responsible officer in *Van Orman* had actually signed the protest and participated in the protest hearing. In this latter connection that court said:

> To say that Van Orman was unaware of the corporation's failure to pay the tax or to contend that he was unaware of his personal liability, in the face of IC 1971, 6-2-1-49 [the former sales tax responsible officer statute] (now repealed) [current version at IC § 6-2.5-2-1(b) (1998)], is ludicrous. All persons are charged with the knowledge of the rights and remedies prescribed by statute. *Middleton Motors, Inc. v. Ind. Dept. [of State Revenue]* (1978), 269 Ind. 282, 380 N.E.2d 79, 81. The clear pronouncement of the statute is, *ipso facto,* sufficient notice that a duty exists to remit the tax fund held in trust. No personal notice of the assessment is required.

416 N.E.2d at 1306, quoted in *Ball I,* 525 N.E.2d at 358 (internal quotation marks omitted).

In the Department's view the rationales of *Ball II* and *Van Orman* made service of the Notices of Proposed Assessment on the original parent enough to impute knowledge, and therefore due process notice, of the FIT liability to the other members of the merged unitary group. As previously noted, the last sentence of IC § 6-5.5-6-1 imposes joint and several liability for a unitary group's FIT on each member of the group. That statute, like the responsible officer collection and remittance statutes at issue in *Ball I, Ball II* and *Van Orman,* gave every member of the merged group general constructive notice of its potential liability for the entire group's FIT. The original parent, like the responsible officers in those opinions, had the ability through majority stock ownership and executive power to control the other members of the group. In the unitary group context, "[u]nity is presumed whenever there is *unity of ownership, operation* and use evidenced by centralized management or *executive force, …or other controlled interaction* among entities that are members of the unitary group[.]" IC § 6-5.5-1-18(b) (emphases added). Since the original parent could control the other members, it is only proper that notice to it should also bind all the other members, including the filer. This is not to say that serving the Notices on the filing member would not have been equally valid. The Department is simply saying that serving the original parent was also permissible, either (as here) in place of, or in addition to, the filer. IC § 6-5.5-6-1 essentially enabled the original parent, as the controlling member of the group, to designate the filing member as its and the group's FIT compliance agent. However, the fact that a principal (in this case the original parent) has an agent does not

ordinarily preclude third parties (e.g., the Department) from dealing directly with the principal, or deprive the principal of the ability to act for itself or entities that it controls. Certainly the original parent did so in filing and prosecuting the present protest, just as the responsible officer in *Van Orman* did on behalf of his corporation, and the protestant therefore cannot claim that it suffered any legal prejudice to its ability to make its case. Like the Court of Appeals in that case, the Department finds the protestant's contention that the Department's service of the Notices of Proposed Assessment on the original parent rather than the filing member voided the assessments to be "ludicrous." 416 N.E.2d at 1306.

As noted in the Statement of Facts, the auditor had two reasons for submitting the Audit Summary under the name of the original parent. One was that the original unitary group (and, by implication, the original parent acting as the common parent for that group) was the same entity that had filed Indiana income tax returns before the FIT was enacted. The other was that the original parent had been the responsible filing member of the federal consolidated group during the audit period. Thus, although the auditor did not rely on Treas. Reg. § 1.1502-77(a) or the responsible officer opinions, she reached the same result as those authorities. It follows that the Department did not err under either the TAA or the FITA in following the auditor's recommendation and issuing the Notices of Proposed Assessment to the original parent, instead of to the Indiana filing member.

FINDING

The merged unitary group's protest is denied as to this issue.

II. Financial Institutions Tax—Imposition—Transacting Business of Financial Institution in Indiana—Regular Solicitation of Business in or Attribution of Receipts to Indiana (1993-96)

Tax Procedure—Protests—Burden of Proof

DISCUSSION

A. INTRODUCTION.

Before turning to the merits of the merged group's argument on this issue, the Department will first give an overview of the relevant parts of the FITA, and regulations promulgated thereunder to put both the argument and the auditor's adjustment in their proper legal contexts. The Department will then discuss the protestant's procedural responsibilities because they are material to the resolution of this issue.

B. OVERVIEW OF RELEVANT PARTS OF THE FINANCIAL INSTITUTIONS TAX ACT

The Indiana Supreme Court has characterized "the FIT [a]s [being]… an excise tax on the exercise of the corporate privilege of operating as a financial institution in Indiana." *Indiana Dep't of State Revenue v. Fort Wayne Nat'l Corp.,* 649 N.E.2d 109, 112 (Ind. 1995).

> More precisely, IC § 6-5.5-2-1(a) "impose[s] on each taxpayer a franchise tax measured by the taxpayer's adjusted gross income or apportioned income for the privilege of exercising [the taxpayer's] franchise or the corporate privilege of *transacting the business of a financial institution in Indiana*." *Id* (emphasis added). IC § 6-5.5-1-17(a) defines "taxpayer" for purposes of the FITA (as distinguished from the TAA) as "a corporation that is transacting the business of a financial institution in Indiana[.]" *Id.* "Transacting the business of a financial institution in Indiana" thus defines both the taxable event and the class of persons subject to the tax. IC § 6-5.5-1-17(d) defines the term "business of a financial institution." The protestant does not dispute that the activities of the filing member and Members A through C during the audit period met that definition. It only disputes whether the auditor should have treated certain of the activities of Members A through C as having been transacted in, or attributed those activities to, Indiana.

IC chapter 6-5.5-3 sets out the rules for determining whether the entity in question is transacting business in Indiana or in some other jurisdiction. IC § 6-5.5-3-1 and its implementing regulation, 45 IAC § 17-2-6, list eight activities that constitute transacting business within Indiana. Of particular relevance in this protest are the rules that a financial institution transacts business within Indiana if it "regularly solicits business from potential customers in Indiana," IC § 6-5.5-3-1(4) and 45 IAC § 17-2-6(4), or "regularly engages in transactions with Indiana customers that involve intangible property, including loans, …[,]" IC § 6-5.5-3-1(6) and 45 IAC § 17-2-6(8). In this context "loan" includes "a lender credit card or similar arrangement[.]" IC § 24-4.5-3-106(3) (1988)(1993).

Once a taxable event has occurred, it is then necessary to determine whether the event is attributable to Indiana. IC §§ 6-5.5-3-2 to -7 set out the guidelines for doing so. The taxable event in the audit at issue in this protest is the existence of intangible assets attributable to Members A through C. Such situations are governed by IC § 6-5.5-3-5, which states in relevant part that "[i]ntangible assets are attributable to this state if the income earned on those assets is attributable to this state under this article." *Id.* The rules for attributing receipts are found in IC chapter 6-5.5-4 and its implementing regulation, 45 IAC § 17-3-10 (1992) (1996). (The auditor relied on paragraphs (b)(6) through (b)(9) of the latter regulation as authority for the assessments for the years in question.)

If a taxable event attributable to Indiana has occurred then, as noted above, the tax imposed is "measured by the taxpayer's adjusted gross income or apportioned income[.]" IC § 6-5.5-2-1(a). Apportionment of income is necessary if the tax is imposed on a nonresident taxpayer as defined in IC § 6-5.5-1-12, i.e. a taxpayer that is transacting business within Indiana as determined under IC chapter 6-5.5-3 but that has its commercial domicile outside Indiana. Members A through C each fit this definition during the audit period. The income of such nonresident taxpayers is apportioned whether transacting the business of a financial institution alone or (as is the case here) as members of a unitary group as defined in IC § 6-5.5-1-18(a). In contrast to the three-factor formula of property, payroll and sales of IC § 6-3-2-2 that is used- to apportion corporate adjusted gross income for adjusted gross income tax purposes, the FITA uses a single-factor apportionment formula based on adjusted gross income (hereinafter "AGI") and receipts. IC §§ 6-5.5-2-3 and -4 respectively set out the formulas applicable to single nonresident taxpayers and unitary groups that include nonresident taxpayers, the latter statute being the one applicable in the present case. Under each statute total AGI of the sole nonresident taxpayer or of all members of the unitary group is multiplied by the quotient of a fraction. Under each statute the numerator of that fraction includes

all receipts of the sole nonresident taxpayer or the unitary group attributable to doing business in Indiana and the denominator consists of total receipts from transacting business in all taxing jurisdictions. IC § 6-5.5-4-1 makes the attribution rules of IC chapter 6-5.5-4 and 45 IAC § 17-3-10 applicable in determining what receipts are to be included in the numerators of the apportionment ratios applicable to nonresident taxpayers, whether they are filing separate returns or (as is the case here) they are members of a unitary group as defined in IC § 6-5.5-1-18(a) that is filing a combined return pursuant to the second paragraph of IC § 6-5.5-6-1. For this purpose IC § 6-5.5-4-2(1) defines "receipts" as gross income as defined in IC § 6-5.5-1-10 and I.R.C. (26 U.S.C.) § 61 (1988) (1994), with certain adjustments not in issue here. In the case of nonresident taxpayers that hold intangible assets attributable to Indiana, IC chapter 6-5.5-4 does simultaneous double duty. It establishes that such assets are attributable to Indiana as taxable events if the income from them is attributable to Indiana, and that the income from them therefore must also be included in the apportionment ratio numerator in computing the FIT.

As noted above, to support the present adjustment the auditor cited to 45 IAC § 17-3-10(b)(6)-(9), which respectively implement IC §§ 6-5.5-4-4 to -6 and -8. IC § 6-5.5-4-4 and 45 IAC § 17-3-10(b)(6) each state that "[i]nterest income and other receipts from assets in the nature of loans or installment sales contracts that are primarily secured by or deal with real or tangible personal property must be attributed to Indiana if the security or sale property is located in Indiana." IC § 6-5.5-4-5 and 45 IAC § 17-3-10(b)(7) both make interest income and other receipts from consumer loans not secured by real or tangible personal property attributable to Indiana if the loan is made to an Indiana resident. IC § 6-5.5-4-6 and 45 IAC § 17-3-10(b)(8) both state in relevant part that "[i]nterest income and other receipts from commercial loans and installment obligations not secured by real or tangible personal property must be attributed to Indiana if the proceeds of the loan are to be applied in Indiana." IC § 6-5.5-4-8 and 45 IAC § 17-3-10(b)(9) each state that "[i]nterest income, merchant discount, and other receipts including service charges from financial institution credit card and travel and entertainment credit card receivables and credit card holders' ['cardholders' ' in the regulation] fees must be attributed to the state to which the card charges and fees are regularly billed." It is inferable from the auditor's citation to 45 IAC § 17-3-10(b)(6)-(9) that she found that Members A through C had transacted business in Indiana during the audit period because they had "regularly engage[ing] in transactions with customers in Indiana that involve intangible property, including loans, …." IC § 6-5.5-3-1(6).

C. THE PROTESTANT HAS THE BURDEN OF PROOF THAT THE PROPOSED ASSESSMENTS ARE WRONG.

The TAA specifies the administrative procedure to be followed in a protest. Under the TAA a taxpayer, defined in IC § 6-8.1-1-5.5 for purposes of that act as "a person liable for the payment of taxes[,]" *id.*, has the burden of proof in a protest. IC § 6-8.1-5-1(b) states that "[t]he burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made.") *Id*. *See also* BLACK'S LAW DICTIONARY 190 (7th ed. 1999) (defining "burden of proof" as a "party's duty to prove a disputed assertion or charge"). The burden of proof is two-fold, consisting of both the burden of persuasion and the burden of production. *Porter Mem'l Hosp. v. Malak*, 484 N.E.2d 54, 58 (Ind. Ct. App. 1985) (noting that "burden of proof" is not a precise term, as it can mean both the burdens of persuasion and production).

The terms "burden of production" and "burden of persuasion" have two distinct meanings. *See State v. Huffman*, 643 N.E.2d 899, 900 (Ind. 1994) (stating that there are "two senses" of the term "burden of proof," the burdens of persuasion and production). The burden of production, also referred to as the burden of going forward, is the taxpayer's "duty to introduce enough evidence on an issue to have the issue decided by the fact-finder." *Id*. In other words, a taxpayer must submit evidence sufficient to establish a prima facie case, i.e., evidence sufficient to establish a given fact and which if not contradicted will remain sufficient to establish that fact. *See Longmire v. Indiana Dep't of State Revenue*, 638 N.E.2d 894, 898 (Ind. Tax Ct. 1994); *Canal Square Ltd. Partnership v. State Bd. of Tax Comm'rs*, 694 N.E.2d 801, 804 (Ind. Tax Ct. 1998). *Cf. Bullock v. Foley Bros. Dry Goods Corp.*, 802 S.W.2d 835, 839 (Tex. App. 1990) (observing, in challenge to state's sales and use tax audit, that comptroller's deficiency determination is prima facie correct and that taxpayer must disprove it with documentation).

In contrast to the burden of production component of the burden of proof, the burden of persuasion is the taxpayer's "duty to convince the fact-finder to view the facts in a way that favors that party." BLACK'S LAW DICTIONARY 190 (7th ed. 1999). That same definition also indicates that the term "burden of persuasion is "[a]lso loosely termed *burden of proof*." *Id* (emphasis in original.) Some cases have referenced this dual meaning. *See, e.g., Peabody Coal Co. v. Ralston*, 578 N.E.2d 751, 754 (Ind. Ct. App. 1991) (observing that in criminal cases, the "State carries the ultimate burden of proof, or burden of persuasion").

Thus, if a taxpayer believes that a proposed assessment is based on incorrect factual findings, it is that taxpayer's burden to produce books, records or other evidence that will prove the true facts. *See* IC §§ 6-8.1-5-4 and -5.5-6-9 (requiring taxpayers to keep books and records necessary to determine liability for any listed tax and for the FIT, respectively). If the taxpayer believes that a proposed assessment is legally insufficient, it is that taxpayer's burden to persuade the Department that the ground on which the assessment is actually based, not the ground the taxpayer may choose or believes was chosen, is erroneous.

D. THE PROTESTANT'S ARGUMENT

IC § 6-5.5-3-4, on which the merged unitary group bases its argument, describes what activities trigger a rebuttable presumption that a person "regularly solicits business … in Indiana" as IC § 6-5.5-3-1(4) uses that phrase. During the audit period IC § 6-5.5-3-4 read, and at this writing still reads, as follows:

> Sec. 4. A person is presumed, subject to rebuttal, to regularly solicit business within Indiana if:
>
> (1) The person conducts activities described in section 1(3), 1(5), and 1(6) of this chapter [IC § 6-5.5-3-1(3), -1(5), and -1(6)] with twenty (20) or more customers within Indiana during the taxable year; or
>
> (2) The sum of the person's assets, including the assets arising from loan transactions, and the absolute value of the person's deposits attributable to Indiana equal at least five million dollars ($5,000,000).

Id. Title 45 IAC § 17-2-9 implements IC §§ 6-5.5-3-1(4) and -4(1), while 45 IAC § 17-2-8 defines and describes the activities that constitute "soliciting business" for purposes of these statutes. Broadly speaking, for a financial institution taxpayer to be soliciting business within the meaning of 45 IAC § 17-2-8, that taxpayer must advertise or disseminate information about its business, in any medium, to potential Indiana customers.

The merged unitary group argues that it has rebutted this presumption as to Members A through C for three reasons, which the merged group appears to offer with reference to IC § 6-5.5-3-4(1). First, the group contends that some of the transactions with these members that the auditor included in the apportionment numerator arose before the customers in question moved into Indiana. Second, the group submits that Members A through C might also buy loans from other financial institutions that had been negotiated and closed outside the state. Finally, the protestant submits that in some instances these members made loans to businesses headquartered outside Indiana but with operations within the state, and that used the loan proceeds in connection with those operations.

E. THE PROTESTANT HAS FAILED TO SUSTAIN ITS BURDEN OF PROOF AS TO THIS ARGUMENT.

However, there are several problems with this argument. First, the merged group has submitted no evidence whatever that any of the transactions to which it arguments refer in fact existed during the reporting periods in question. Nor has the protestant submitted evidence that the sum of its assets and deposits attributable to Indiana during those periods fell below the $5,000,000 minimum of IC § 6-5.5-3-4(2). Second, the merged unitary group has failed to persuade the Department that IC §§ 6-5.5-3-1(4) and -4(1) even govern this protest, let alone that the merged group has rebutted the presumption that the latter section creates. The Audit Summary in particular did not cite these statutes or 45 IAC §§ 17-2-8 or -9 to support the adjustment, which would have been a simple thing for the auditor to do if that had been her intent. Nor is there any evidence in the record, either provided by the merged group or in the audit file, of Members A through C "soliciting business" within the meaning of that regulation during the reporting periods in question for the merged unitary group to rebut under IC § 6-5.5-3-4.

G. IC § 6-5.5-3-1(6) DESCRIBES THE TAXABLE EVENT THAT OCCURRED.

Third, IC § 6-5.5-3-1(6), rather than IC §§ 6-5.5-3-1(4) and -4(1), was the basis for the auditor's adjustment. As previously noted, the auditor cited 45 IAC § 17-3-10(b)(6)-(9) in the Audit Summary. The Department infers from this citation and the relevant entries in the Audit Summary and the auditor's workpapers that Members A through C had transacted business in Indiana by regularly engaging with Indiana customers in transactions having intangibles, i.e. loans, as their subjects. Members A through C thereby brought themselves within the scope of IC § 6-5.5-3-1(6). IC § 6-5.5-3-4(1) does cite IC § 6-5.5-3-1(6) as describing one of the three predicate forms of transacting business in Indiana that can support a finding that a financial institution has also regularly solicited business within Indiana under IC § 6-5.5-3-1(4). However, that institution must also in addition have "solicit[ed] business" as described in 45 IAC § 17-2-8. As previously noted, there is no evidence in the record to indicate that Members A through C engaged in any such solicitation.

Moreover, and more importantly, IC § 6-5.5-3-1(6) makes engaging in intangible property transactions with Indiana customers an independent taxable event. This is the case in part because of the structure of IC § 6-5.5-3-1, which uses the word "or" between subsections (7) and (8) to describe the relationship among all of the subsections. "The word 'or' is used in the disjunctive sense, indicating that various parts of the sentence which it connects are to be taken separately." *State v. Levitt,* 203 N.E.2d 821, 827 (Ind. 1965). Disjunctive and conjunctive terms within statutes "should ordinarily be given their literal and normal definition when it is apparent that the resulting meaning was intended[.]" *Dague v. Piper Aircraft Corp.,* 418 N.E.2d 207, 211 (Ind. 1981). "[W]here the legislature uses the disjunctive 'or,' and no portion of the statute is thereby rendered meaningless, effect must be given to the plain words used by the legislature." *Babinchak v. Town of Chesterton,* 598 N.E.2d 1099, 1103 (Ind. Ct. App. 1992).

However, soliciting and engaging in transactions are also distinct taxable or legal events by virtue of the common definitions of the verbs "solicit," "engage" and "transact," the nouns "solicitation" and "transaction" and the definition of "soliciting business" in 45 IAC § 17-2-8. "[U]nless the construction is plainly repugnant to the intention of the legislature or of the context of the statute: (1) Words and phrases shall be taken in their plain, or ordinary and usual, sense." IC § 1-1-4-1(1). "It is axiomatic in Indiana that the plain, ordinary, and usual meaning of non-technical words in a statute is defined by their ordinary and accepted dictionary meaning." *Johnson County Farm Bureau Coop. Ass'n, Inc. v. Indiana Dep't of State Revenue,* 568 N.E.2d 578, 581 (Ind. Tax Ct. 1991), *aff'd and adopted* 585 N.E.2d 1336 (Ind. 1992). The verb "solicit" means in relevant part "to approach with a request or plea (as in selling or begging) …." WEBSTER'S THIRD NEW INT'L DICTIONARY 2169 (4th ed. 1976) (definition 3) (hereinafter "WEBSTER'S THIRD"). The relevant definition of the derivative noun "solicitation" is " [a]n attempt or effort to gain business …." BLACK'S LAW DICTIONARY 1398 (7th ed. 1999) (definition 4) (hereinafter "BLACK'S"). In other words, a solicitation is an effort by the soliciting party to make intended recipients of the solicitation aware of a commercial opportunity with the aim of initiating a business relationship with one or more of those recipients. Title 45 IAC § 17-2-8 describes activities of this type. It is obvious, both from the dictionary definitions of "solicit" and "solicitation" and from the descriptions of the activities in the regulation, that "soliciting business" as defined in that regulation would occur for purposes of IC §§ 6-5.5-3-1(4) and -4(1) at the beginning of any resulting business relationships with Indiana customers.

In contrast, the short definition of the intransitive verb "engage" is "[t]o employ or involve oneself; to take part in; to embark on." BLACK'S at 549. The relevant general dictionary definitions of that verb are as follows: "to begin and carry on an enterprise, esp[ecially] a business or profession … to employ or involve oneself … to take part **:** PARTICIPATE …." WEBSTER'S THIRD at 751 (definitions 2 a, 2 b and 2 c) (emphasis in original). The relevant definition of the noun "transaction" in the same dictionary simply describes it as "something that is transacted : as … a business deal[.]" *Id.* at 2425-2426 (definition 2 a). A definition in another dictionary is more explicit, defining "transaction" as "[t]he act or an instance of conducting business or other dealings." BLACK'S at 1503 (definition 1). The relevant definition in the same dictionary of the verb "transact," from which "transaction" is derived, is "[t]o carry on or conduct (negotiations, business, etc.) to a conclusion <transact business>." *Id* (definition 1). A transaction thus deals with a whole course of business conduct between two or more parties, while a solicitation is an isolated act that occurs at the beginning of any resulting transaction.

Engaging in and soliciting a transaction thus are distinct, albeit related, activities. They may, but need not necessarily, overlap in any given transaction. The creditor in a transaction may not have initially solicited it, but may nevertheless be engaged in it, as is the case where the creditor is an assignee, holder in due course or other successor in interest. Even where soliciting and engaging in a particular transaction do overlap, the fact that the solicitation may have occurred in one jurisdiction does not prevent or preclude engaging in that transaction in another jurisdiction.

Thus, even assuming without deciding that the factual representations in the merged group's argument were true, those "facts" would not be enough to invalidate the proposed assessments. The fact that the intangible property transactions attributed to Indiana were solicited and closed elsewhere, either by Members A, B or C or another financial institution to which the member in question succeeded as assignee or holder in due course, did not preclude that member from engaging in those transactions in Indiana. This was so regardless of whether the debtors in question were businesses headquartered elsewhere, but with in-state operations, or consumers who sometime during the course of their respective transactions became Indiana residents. The protestant has thus failed to meet its burden of proof that the assessment is wrong. *See* IC § 6-8.1-5-1(b) and *Malak,* 484 N.E.2d at 58, both discussed above.

FINDING

The merged unitary group's protest is denied as to this issue.

III. Tax Procedure—Adjustments to Federal Returns—Timeliness of Notice to Department (1993)

A. THE PROTESTANT'S ARGUMENT

As noted in the Statement of Facts, the auditor declined to adjust the original group's liability for calendar year 1993 on the ground that the changes had not been reported to the Department within one hundred twenty (120) days after the modification to the federal return for that year. The protestant submits that the auditor's action was erroneous for three reasons. First, the merged unitary group argues that its 120-day reporting period should not have started running until July 7, 1998, the date of a clearance and closure letter for calendar years 1992-93 it alleges it received from the IRS Joint Committee on Taxation. Second, the merged group contends that IC § 6-5.5-6-6, the section of the FITA that imposes the 120-day reporting requirement, does not impose any sanction for failing to meet that deadline. Third, the protestant submits that the auditor discriminated against it by accepting as timely notifications of changes that increased its FIT liability, while declining to accept a change that decreased that liability and entitled it to a refund of or credit against its FIT.

B. THE 120-DAY NOTIFICATION DEADLINE RAN FROM THE DATE THE ORIGINAL UNITARY GROUP'S FEDERAL FORM 1120X FOR 1993 WAS SUBMITTED.

The Department notes that the merged unitary group has not submitted a copy of the purported clearance and closure letter for 1992-93 in support of its protest. The Department therefore

would be justified in declining to address the merged group's argument based on that purported letter for failing to sustain its burdens of production and proof. IC § 6-8.1-5-1(b); *Huffman,* 643 N.E.2d at 900; *Longmire,* 638 N.E.2d at 898; *Canal Square Ltd. Partnership,* 694 N.E.2d at 804. However, even if any such letter existed and was dated July 7, 1998, it would not be enough to justify the Department's granting the protestant the benefit of the 1993 reduction. IC § 6-5.5-6-6(b) states that "[t]he taxpayer shall file the notice in the form required by the department within one hundred twenty (120) days after the alteration or modification is made by the taxpayer or finally determined, *whichever occurs first.*" *Id* (emphasis added). Such records as exist indicate that the original unitary group must have submitted its Form 1120X for 1993, and that the 120-day reporting period must have expired, before the IRS allegedly issued the purported July 7, 1998 clearance and closing letter to the protestant.

The original unitary group was deemed to have paid its remaining outstanding tax liability for 1993, and filed its return, on March 15, 1994, notwithstanding that it actually filed its return on September 14, 1994 pursuant to an automatic extension of time for which it had applied. *See* I.R.C. § 6513(a) (stating that returns filed, or taxes paid, before the last day prescribed for doing so are deemed filed on the prescribed last day, notwithstanding any extension of time the taxpayer may have been granted). The three-year period of limitations created by operation of I.R.C. § 6511(a) for the original unitary group to claim a refund began on that date and would have ended on March 15, 1997. Thus, the last possible date on which the original unitary group could have submitted its 1993 Form 1120X, March 15, 1997, was nearly sixteen months before the IRS allegedly issued its purported July 7, 1998 clearance and closure letter for calendar years 1992-93. However, the protestant's contact person stated in her March 30, 1998 conversation with the auditor that the original unitary group had filed its 1120X for 1993 in 1995. Assuming, without finding, that recollection to be accurate, and further assuming for purposes of this analysis a filing date of December 31, 1995, the original group should have given the Department notice of that modification at the latest by April 30, 1996. Either way, the 1120X had to have been filed well before the purported clearance and closure letter. Since that is the case, the 120-day period for the original group to notify the Department of the change for 1993 cannot be measured from July 7, 1998 as the merged unitary group contends. Instead, by operation of IC § 6-5.5-6-6(b), quoted above, that period must be measured from the date the 1120X was filed, which would have been March 15, 1997 at the latest. The notification period therefore would have run on July 13, 1997 at the latest. There is no written notice in the audit file from either the original group or the merged group to the Department notifying it of the change to the original group's federal income, as IC § 6-5.5-6-6(b) requires. *See id* (stating that "[t]he taxpayer shall *file* the notice in the *form* required by the department ….) (emphases added). The only evidence in the file indicating that the Department had actual knowledge (as distinguished from statutory notice) indicates that the protestant did not communicate the change until over eight months later, in the March 30, 1998 conversation between its contact person and the auditor. The conversation thus was untimely even if it could have constituted notice under IC § 6-5.5-6-6(b), which it could not.

C. THE PENALTY FOR FAILING TO NOTIFY THE DEPARTMENT OF THE ORIGINAL UNITARY GROUP'S DECREASE IN FEDERAL TAXABLE INCOME FOR 1993 WAS THE LOSS OF ANY RESULTING REFUND OF FINANCIAL INSTITUTIONS TAX.

The merged unitary group argues that any failure by it or the original unitary group to give statutory notice is immaterial and should not act to deprive the combined group of a favorable adjustment because IC § 6-5.5-6-6 does not set out any sanction for such failure. It is true that IC § 6-5.5-6-6 does not contain any penalty for noncompliance; however, that omission is immaterial because other authorities, discussed below, state or imply the consequences of failing to give timely notice. The crucial facts in determining which of these authorities applies to the present issue are the merged group's filing an 1120X for 1993 and the resulting reduction in the original group's federal taxable income for that year (assuming the facts contained in the 1120X were as represented to the IRS). That filing and reduction potentially entitled the protestant to a refund of FIT the original unitary group paid for 1993. Therefore, in addition to the merged or original group giving the Department notice within 120 days of the reduction in the latter's 1993 federal income pursuant to IC § 6-5.5-6-6(b), the protestant also had to file a claim with the Department if it wished to receive any resulting refund. The applicability of the authorities governing the latter procedure is critical to the present argument because Indiana law is well settled that where the same section of a tax refund claim statute both creates the right to a refund and specifies the time period for the exercise of that right,

> the provision in fact creates a condition precedent to the statutory right of refund. The legislature may make the very existence of the right of recovery dependent upon the petition for refund being made within three years from the date the taxes are paid. A statute of limitations does not create or extinguish a right. It only places limitations upon a remedy which may be tolled or waived. The limitation in the instant case, however, is a condition essential to the existence of the right and cannot be tolled or waived.

Marhoefer Packing Co. v. Indiana Dep't of State Revenue, 301 N.E.2d 209, 216 (Ind. Ct. App. 1973). This language also requires interpreting IC § 6-5.5-6-6(b) as making the 120-day notification requirement, as applied to modifications that decrease federal income, a further condition precedent to entitlement to any refund of FIT that decrease may create.

Unlike some other listed tax statutes, which include specific sections that set out the procedure to claim a refund or credit under those laws, there are no such provisions in the FITA. The current version of the general refund claim statute, IC § 6-8.1-9-1, which is part of the TAA, therefore governs the procedure for claiming a refund of FIT. IC § 6-8.1-9-1(a) states in substance that a person who has paid more tax than was legally due may file a claim for refund of that tax, but must do so within three years of the later of the due date of the return for the period for which the person made the overpayment, or the date of payment. Subsection (b) of the regulation implementing IC § 6-8.1-9-1, 45 IAC § 15-9-2, quite clearly states: "The department has no legal method of generating a claim for refund. A claim for refund can only be initiated pursuant to IC § 6-8.1-9-1[.]" Thus, if only the person who has determined that s/he has overpaid tax can claim a refund, and the Department cannot itself generate a refund without a claim, then it follows that that person will lose the refund if s/he files no claim, or fails to do so within the statutory three-year period. In this connection *Marhoefer Packing* observes that

> This view is consonant with avoidance of stale and fiscally disruptive claims. If no time limitation were placed upon refund claims, budgetary and fiscal planning

> would be rendered unduly difficult in that the amount of revenue available at any given time to defray the expenses of government would be uncertain as subject to stale claims.

301 N.E.2d at 215. The same policy dictates that a financial institutions taxpayer that fails to give timely notice of a reduction to its federal income lose any resulting refund, particularly where that failure would hinder the Department's ability to complete audits and propose accurate assessments. In addition, failure to give notice or file a claim in time, or at all, deprives the Indiana Tax Court of subject-matter jurisdiction over that refund. *See* IC § 33-3-5-11(a) (1998 and Supp. 2002) (stating that "[i]f a taxpayer fails to comply with *any* statutory requirement for the initiation of an original tax appeal, the tax court does not have jurisdiction to hear the appeal[ ]") (emphasis added); *Marhoefer Packing,* 301 N.E.2d at 219 (failure to file claim within three years), approved in *Middleton Motors, Inc. v. Indiana Dep't of State Revenue,* 380 N.E.2d 79, 81 (Ind. 1978) (three-month requirement for filing suit for refund, citing *Marhoefer*); and *GasAmerica Services, Inc. v. Indiana Dep't of State Revenue,* 552 N.E.2d 860, 862 (Ind. Tax Ct. 1990) (failure to file any claim).

It was thus unnecessary for IC § 6-5.5-6-6 to specify any sanctions for failure to give the Department timely notice of a modification that decreases federal income. The authorities discussed above already gave potential refund claimants such as the protestant and the original unitary group constructive notice of those sanctions, i.e. loss of the refund and loss of the right to seek judicial review of any issues concerning that refund. "All persons are charged with the knowledge of the rights and remedies prescribed by statute." *Middleton Motors,* 380 N.E.2d at 81.

D. THE AUDITOR TREATED ALL YEARS FOR WHICH ADJUSTMENTS TO FEDERAL TAXABLE INCOME WERE REPORTED WAS CONSISTENT.

The first above-quoted passage from *Marhoefer Packing* also serves as a response to the protestant's argument that the auditor and the Department applied IC § 6-5.5-6-6 inconsistently as between 1993 and the other years for which the combined unitary group gave belated notice. The difference between modifications that give rise to potential FIT refunds and those that increase FIT liability justifies treating failures to notify the Department of these two kinds of modifications differently. A failure to give notice of a modification that decreases federal income, either alone or in combination with a failure to file a claim for any resulting refund of FIT, is a failure to satisfy a condition precedent to that claim, will extinguish it and will deprive the Department of administrative discretion to entertain it. *Marhoefer Packing,* 301 N.E.2d at 215 and 216, both quoted above. In contrast, a failure to give the Department notice, or timely notice, of a federal modification that increases federal income will equitably estop the taxpayer from invoking, and will equitably toll, the assessment statute of limitations. *Salin Bancshares, Inc. v. Indiana Department of State Revenue,* 744 N.E.2d 588, 595-596 (Ind. Tax Ct. 2000). Although the Indiana Tax Court did not decide *Salin Bancshares* until after the audit was completed, the auditor's acceptance of the modifications that increased the original unitary group's federal income for calendar years 1990-92 was consistent with the holding in that opinion. Similarly, although the auditor did not rely on *Marhoefer Packing,* her refusal to recognize the 1993 modification was consistent with that opinion's interpretation of the nature of, and the conditions precedent required for, a refund claim.

As noted above in connection with the combined group's first argument, based on the incomplete record of the time line, it had to give the Department notice of the modification to the original group's 1993 federal income by July 13, 1997 at the latest. However, the merged group never provided the auditor, and has never provided the Department during this protest, any proof that it satisfied this condition precedent and gave the Department timely notice of that modification, nor has the Department found any such notice in its records. In addition, neither the original unitary group, nor the protestant as its successor in interest, ever claimed a refund of any refund of FIT resulting from the reduction of the original unitary group's 1993 federal income. The auditor therefore was, and the Department is, fully legally justified in refusing to give the combined group the benefit of the decrease in the original group's 1993 federal income reported on its 1120X.

FINDING

The merged unitary group's protest is denied as to this issue.

IV. Financial Institutions Tax—Imposition—Constitutionality—Due Process Nexus (1993-96)

Financial Institutions Tax—Imposition—Constitutionality—Interstate Commerce—Substantial Nexus (1993-96)

Financial Institutions Tax—Imposition—Constitutionality—Interstate Commerce—Fairness of Apportionment and Discrimination (1993-96)

Financial Institutions Tax—Credits—Non-Resident Taxpayers—Constitutionality--Fairness of Apportionment and Discrimination (1993-96)

DISCUSSION

A. THE LACK-OF-SUBSTANTIAL-NEXUS ARGUMENT

The protestant contends that IC §§ 6-5.5-3-1(4) and -4 and IC chapter 6-5.5-4 are unconstitutional because Members A through C allegedly do not have any substantial nexus with Indiana. The merged unitary group submits that these parts of the FITA are unconstitutional on their faces because they allegedly use a so-called "economic presence" standard for nexus. The merged group submits that the alleged use of this standard violates both the dormant Interstate Commerce and Fourteenth Amendment Due Process Clauses (U.S. CONST. art. I, § 8, cl. 3 and amend. XIV, § 1, respectively). It argues that the United States Supreme Court has interpreted these constitutional provisions as requiring a physical presence in a taxing jurisdiction. In support of its lack-of-due-process-nexus argument the protestant quotes from *Miller Brothers Co. v. Maryland,* 74 S.Ct. 535 (U.S. 1954). In support of its lack-of- substantial-nexus argument the merged unitary group quotes from and discusses *Complete Auto Transit, Inc. v. Brady,* 97 S.Ct. 1076 (U.S. 1977), *Quill Corp. v. North Dakota ex rel. Heitkamp,* 112 S.Ct. 1904 (U.S. 1992), *J. C. Penney National Bank v. Johnson,* 19 S.W.3d 831 (Tenn. Ct. App. 1999) and *America Online, Inc.*

v. Johnson, Cause No. 97-3786-III, slip op. (Tenn. Ch. Ct. Mar. 13, 2001), *aff'd* Cause No. M2001-00927-COA-R3-CV, 2002 Tenn. App. LEXIS 555 (Tenn. Ct. App. July 30, 2002).

A challenge to a state taxation statute on the grounds that the taxpayer in question lacks a due process or substantial nexus with the taxing jurisdiction requires the reviewing authority to evaluate the nature and extent of the contacts between that taxpayer and that jurisdiction. Such an inquiry is necessarily fact-sensitive in nature. For this reason, the authority that has to rule on an attack on either of these grounds ordinarily frames the issue as being whether the taxing authority applied the statute to the taxpayer in question in an unconstitutional way, rather than whether the statute is unconstitutional on its face. Had the present challenge been made on an as-applied basis, the Department could have ruled on it. Instead, however, the merged group has challenged IC §§ 6-5.5-3-1(4) and -4 and IC chapter 6-5.5-4 on their faces. As the Department discussed under Issue I above, Members A through C transacted business in Indiana under IC § 6-5.5-3-1(6) rather than under IC §§ 6-5.5-3-1(4) and -4. However, that circumstance does not moot the present issue, since IC § 6-5.5-3-5 makes the attribution rules of IC chapter 6-5.5-4 applicable to determine whether an intangible asset is attributable to Indiana. Accordingly, the Department is barred from ruling, and declines to rule on, the protestant's lack-of-substantial-nexus argument on the authority of IND. CONST. art. III, § 1 as interpreted in *Grazer* and *Standard Oil,* and *Sproles,* all discussed under Issue I above. If the merged unitary group wishes to pursue this argument, it will have to do so through an appeal to the Indiana Tax Court and, if necessary, to the Indiana Supreme Court, since they are the only courts in Indiana that have jurisdiction to rule on facial constitutional attacks on state tax statutes. The Department would note, however, that in any such appeal the merged group will have the heavy burden of proving "that *no* set of circumstances exists under which the [challenged] Act would be valid." *United States v. Salerno,* 107 S.Ct. 2095, 2100 (U.S. 1987) (emphasis added).

B. THE UNFAIR APPORTIONMENT AND DISCRIMINATION ARGUMENTS

The protestant argues that the apportionment formula of IC § 6-5.5-2-4 also violates the dormant Interstate Commerce Clause. Specifically, the merged unitary group contends that IC § 6-5.5-2-4 fails the internal consistency prong of *Complete Auto Transit*'s fair apportionment test. In support of its position the merged group quotes from the internal consistency discussion found in *Oklahoma Tax Commission v. Jefferson Lines, Inc.,* 115 S.Ct. 1331, 1338 (U.S. 1995). (That discussion in turn cites *Container Corporation of America v. Franchise Tax Board,* 103 S.Ct. 2933, 2942 (U.S. 1983), where the United States Supreme Court first articulated the internal and external consistency requirements for fair apportionment.) The protestant further submits that because IC § 6-5.5-2-4 allegedly unfairly apportions, it also unfairly discriminates against interstate commerce. In support of this latter proposition the merged unitary group cites *Armco, Inc. v. Hardesty,* 104 S.Ct. 2620 (U.S. 1984).

Lastly, the merged group argues that IC § 6-5.5-2-6, which grants a credit against the FIT for net income, franchise or equivalent taxes owed to a nonresident taxpayer's domiciliary state, does not completely cure the alleged constitutional defects of IC § 6-5.5-2-4. In particular, the merged group contends that IC § 6-5.5-2-6(a) imposes two alleged limitations on that credit that IC § 6-5.5-2-5 (repealed 2000), the statute granting a credit to resident taxpayers or resident members of unitary groups that engage in operations in other jurisdictions, does not impose. The

protestant accordingly has asked the Department to grant it credits against the proposed assessments for the years in question under IC § 6-5.5-2-5 instead.

The United States Supreme Court has said that "the internal consistency test focuses on the *text* of the challenged statute and *hypothesizes* a situation where [all] other States have passed an identical statute." *Goldberg v. Sweet,* 109 S.Ct. 582, 589 (U.S. 1989) (emphases added). A claim that a state tax statute's apportionment formula is unfair because it is internally inconsistent is thus a facial attack on the constitutionality of the apportionment statute. It follows that a claim that a state tax discriminates against interstate commerce because it is unfairly apportioned is also a facial attack. *See id; see also Armco,* 104 S.Ct. at 2624 (indicating that "the allegation [was] that a tax on its face discriminate[d] against interstate commerce[ ]"). Accordingly, the Department is barred from ruling, and declines to rule, on the merged group's unfair apportionment and discrimination arguments on the authority of IND. CONST. art. III, § 1 as interpreted in *Grazer* and *Standard Oil,* and *Sproles,* all discussed under Issue I above. If the merged unitary group wishes to pursue these arguments, it will have to do so through an appeal to the Indiana Tax Court and, if necessary, to the Indiana Supreme Court, since they are the only courts in Indiana that have jurisdiction to rule on facial constitutional attacks on state tax statutes.

The Department also cannot entertain the protestant's request for credit under IC § 6-5.5-2-5, not only because that request derives from the merged unitary group's constitutional arguments but also for two other, non-constitutional legal reasons. The first is that "[t]he right to the credit claimed is a privilege granted by the Government, and hence the statute is to be strictly construed in favor of the Government." *Burroughs Adding Machine Co. v. Terwilliger,* 135 F.2d 608, 610 (6th Cir. 1943) (citing *Swan & Finch Co. v. United States,* 23 S.Ct. 702, 703-704 (U.S. 1903)). "The statutes' operation will not be extended by construction." *TPQ Inv. Corp. v. State ex rel. Oklahoma Tax Comm'n,* 954 P.2d 139, 141 (Okla. 1998) (citing *Omaha Pub. Power Dist. v. Nebraska Dep't of Revenue,* 537 N.W.2d 312, 314 (Neb. 1995)). *Keyes v. Chambers,* 307 P.2d 498 (Or. 1957), is the best explanation of the reasons for strict interpretation of credit statutes that the Department has found. In *Keyes* the Oregon Supreme Court said:

> A provision allowing a credit against a state tax is, in effect, an exemption from liability for a tax already determined and admittedly valid. It is, therefore, in order to note before proceeding further that such credits, deductions or exemptions as the legislature may allow in the computation of an income tax are privileges accorded as a matter of legislative grace and not as a matter of taxpayer right. 85 CJS, 771-772, Taxation § 1099; *Palmer v. State Commission,* 156 Kan. 690, 135 P.2d 899 [(1943)]; *Southern Weaving Co. v. Query,* 207 S.C. 307, 34 S.E.2d 51 [(1945)]. By reason of their character as legislative grants, statutes relating to deductions allowable in computing income must be strictly construed against the taxpayer and in favor of the taxing authority. *Miller v. McColgan,* 17 Cal.2d 432, 110 P.2d 419, 424 [(1941)]; *Bigelow v. Reeves,* [149 S.W.2d 499, 501 (Ky. 1941)]; *Tupelo Garment Co. v. State Tax Commission,* 178 Miss. 730, 173 So. 656 [(1937)]; *State ex rel. Whitlock v. State Board of Equalization,* 100 Mont. 72, 45 P.2d 684 [(1935)]; *Cudahy v. Wisconsin Dept. of Taxation,* 261 Wis. 126, 52 N.W.2d 467 [(1952)]. The rule of strict construction to which we refer is equally applicable to tax credits. *Burroughs Adding Machine Co. v. Terwilliger*

> (CCA 6th) 135 F2d 608, 610; *Miller v. McColgan,* supra (at p 441). A "credit" to a tax has a far greater impact on the ultimate liability of the taxpayer than an allowable deduction and, therefore, is an item of greater importance as a subject for strict construction in favor of the government.

Id. at 501. *Accord, Burlington N. R.R. v. Strackbein,* 398 N.W.2d 144, 146 (S.D. 1986) and *Stephens v. Vermont Dep't of Taxes,* 353 A.2d 355, 356 (Vt. 1976). "The [merged group] must therefore bring itself strictly within the statutory provisions, and here it has not done so." *Burroughs Adding Machine,* 135 F.2d at 610. Indeed, the protestant, as a unitary group consisting partly of nonresident taxpayers, cannot bring itself within the terms of a credit that IC § 6-5.5-2-5 explicitly makes available only to resident taxpayers.

The second reason relates to the Department's lack of power to grant, and follows from the merged unitary group's inability to claim, a credit under IC § 6-5.5-2-5. It is well-settled Indiana administrative law that "[b]ecause administrative agencies are creations of the legislature, they generally cannot exercise powers beyond those specifically granted by the General Assembly." *State ex rel. ANR Pipeline Co. v. Indiana Dep't of State Revenue,* 672 N.E.2d 91, 94 (Ind. Tax Ct. 1996) (citing *Auburn Foundry, Inc. v. State Bd. of Tax Comm'rs,* 628 N.E.2d 1260, 1263 (Ind. Tax Ct. 1994)). "Administrative agencies have no common law or inherent powers; they have only the authority the legislature expressly or impliedly grants them." *Auburn Foundry, id.* Since the Department can only grant a credit under IC § 6-5.5-2-5 if a financial institution or unitary group meets all the qualifications for that credit, it follows that the Department does not even have the power, much less the discretion, to do so if the financial institution or unitary group in question does not qualify. The Department can only enforce the FITA as it is, not as the protestant would like it to be. If the merged unitary group wants the Department to have that kind of discretion (constitutional issues aside), it needs to petition the legislature to amend the FITA.

FINDING

The merged unitary group's protest is denied as to these issues.

V. Tax Administration—Negligence Penalties (1993-96)—Reasonable Difference of Opinion as to Liability for Tax

The protestant argues that the Department should abate the proposed negligence penalties for calendar years 1993-95 and the periods ending March 31, 1996 and December 31, 1996. In the merged unitary group's view a reasonable difference of opinion exists as to whether the "economic presence" theory of nexus under the FITA is constitutional, creating reasonable cause for the abatement of the penalties for these periods.

IC § 6-5.5-7-1(a) (1993) requires the Department to assess the negligence penalty prescribed in IC § 6-8.1-10-2.1(b) (1993), which is part of the general negligence penalty provision of the TAA, on any FIT taxpayer that fails to make payments of that tax as IC chapter 6-5.5-6 requires. IC § 6-8.1-10-2.1(d) and 45 IAC § 15-11-2(c) (1992) (1996) require the Department to waive the penalty if the taxpayer makes a showing of reasonable cause; the latter subsection defines "reasonable cause," while 45 IAC § 15-11-2(b) defines "negligence."

Generally speaking, if a taxpayer has a reasonable, good faith basis for failing to pay a listed tax, that basis constitutes reasonable cause to abate any negligence penalty the Department proposes to assess, or in fact assesses, for that failure. *Indiana Dep't of State Revenue v. Harrison Steel Castings Co.,* 402 N.E.2d 1276, 1278-1279 (Ind. Ct. App. 1980), *overruling, id.* at 1279 n.2, *Indiana Dep't of State Revenue v. Sohio Petroleum Co.,* 352 N.E.2d 95, 101-102 (Ind. Ct. App. 1976). The Department recognizes that a difference of legal opinion on the constitutionality of "economic presence"-based financial institutions franchise tax statutes exists. However, determining whether that difference of opinion is *reasonable,* i.e. whether the original group had, and the merged group has, a reasonable basis for their failure to pay the FIT the Department proposes to assess would require it to examine the validity of the protestant's facial constitutional attacks on IC § 6-5-5-2-4 and –6. IND. CONST. art. III, § 1 as interpreted in *Grazer* and *Standard Oil,* and *Sproles,* all forbid the Department from engaging in such an examination for the reasons discussed under Part A of Issue I, and Issue IV, above. The Department cannot do indirectly what it is forbidden, and lacks authority, to do directly; it cannot go through a constitutional back door if it is forbidden to go through the constitutional front door. If the merged unitary group wants relief from the negligence penalties for these periods, it can seek such relief in an appeal to the Indiana Tax Court if it so chooses, together with any constitutionally grounded challenge to its proposed substantive tax liability for the same periods it may choose to make.

FINDING

The merged unitary group's protest is denied as to this issue.

VI. Tax Administration—Negligence Penalties (1990-92)—Reasonable Cause—Merger and Layoff of Compliance Personnel

The protestant contends that reasonable cause exists to abate the proposed negligence penalties for calendar years 1990-92 due to the "reverse acquisition" merger of the original unitary group and attendant layoff of tax compliance personnel. The merged unitary group alleges that these events caused it to fail to timely report certain adjustments to its federal corporate returns to the Department. These adjustments were presumably made in the RARs for calendar years 1990-91, and the 1120X for calendar year 1992, of the original group that neither it nor the merged group produced until the audit.

However, the auditor did not propose the negligence penalties for these years based on the original or merged unitary groups' failures to give the Department notice of modifications to federal income, i.e. for failing to comply with IC § 6-5.5-6-6. As noted in the Statement of Facts, the auditor did so because the original group failed to follow the regulations on sourcing of loan, credit interest and fee receipts and failed to report and pay the tax on such items. Since the merged group has argued for abatement of the penalties for these years on grounds other than those that the auditor used, the protestant has failed to meet its burdens of persuasion and proof on this issue that reasonable cause exists to abate these penalties. IC § 6-8.1-5-1(b).

FINDING

The merged unitary group's protest is denied as to this issue.